In the United States Bankruptcy Court
for the
Southern District of Georgia
Brunswick Division

In the matter of:	)	
	)	Adversary Proceeding
ROBERT REID MANER	)	
(Chapter 7 Case 90-20400)	)	Number 90-2021
	)	
Debtor	)	
	)	
	)	
	)	
JOHN W. JAMISON, III	)	
	)	
Plaintiff	)	
	)	
	)	
	)	
v.	)	
	)	
ROBERT REID MANER	)	
	)	
Defendant	)	

MEMORANDUM AND ORDER

FINDINGS OF FACT

Plaintiff, John W. Jamison, III ("Jamison"), became a limited partner in an entity known as Chateau DeVille, Ltd., a single asset limited partnership which owned a 174 unit apartment complex in Huntsville, Alabama, known as Chateau DeVille Apartments. Debtor, Robert Reid Maner, served as one of the general partners of Chateau DeVille, Ltd. Jamison's business experience includes several years work as

a mortgage banker and in connection with that career had had prior dealings with Jack Fiorella, III, ("Fiorella") a co-general partner of the Debtor in Chateau DeVille, Ltd. In fact Jamison had acted as a mortgage banker and brokered the first mortgage loan in behalf of Fiorella at the time Fiorella acquired the apartment complex from a previous owner. Thus, he was very familiar not only with Fiorella, but also with the project.

Fiorella called Jamison in early September 1987 indicating that he needed to obtain funds for investment in the project and Jamison agreed to meet. On September 10, 1987, Jamison, his CPA, Fiorella, and an associate of Fiorella's met. Jamison was provided a brochure on the apartments which contained a representation that the apartments were 99% occupied (Exhibit P-3). Fiorella was specifically questioned and affirmed that figure to be accurate. The brochure also contained a proforma operating statement which showed that the project would operate with a positive cash flow within three months based on 95% projected occupancy. Fiorella, however, represented to Jamison that the project was already operating at a positive cash flow. It was further represented to Jamison that all of the apartments had individual utility meters and therefore the partnership bore none of the utility expenses of any of the tenants. Finally, Fiorella told Jamison that he was in negotiations with a purchaser for the project who had verbally offered to purchase the complex at a price that would yield a $300,000.00 profit to the partnership but that he was holding out for a higher profit margin. Nevertheless he told Jamison that he expected a quick sale to this purchaser, the J. M. Jason Company, which was known to Jamison as a sophisticated investor in similar real estate. In fact, on September 8, 1987, Jason had advised Fiorella that its interest had "ebbed substantially" and that Jason would "pass" on the deal (Pyzikiewicz Deposition pages 54, 74, 80, 84). Fiorella explained his need for infusion of capital on the basis that a payment was coming due on the second mortgage which required a large cash payment that the partnership did not currently have. Jamison met with Fiorella and others a second time on September 11, 1987, at which time all the representations of the previous day were repeated. On or about September 28, 1987, Jamison executed the Amended Limited Partnership Agreement and became a limited partner in Chateau DeVille, Ltd.

Paragraph 16.1 of the Amended Limited Partnership Agreement prohibited the

commingling of partnership funds with property of any other entity. Paragraph 9.1 of Exhibit P-4 authorized the limited partnership to employ Equity Resources Management, Inc. ("ERMI"), a general partner of the limited partnership, to manage the complex for a fee of 6% of gross rentals.

On or about September 28, 1987, First Commercial Bank extended a loan in the amount of one million dollars to the limited partnership which Jamison was required to co-sign as a condition to becoming a limited partner. He likewise executed a separate guarantee agreement which was also required of him (Exhibits P-5 and P-6). He pledged two personal letters of credit totalling $350,000.00 to First Commercial Bank as additional collateral for the advance and First Commercial Bank took a third mortgage on the premises as additional collateral for its indebtedness. The first mortgage is held by Union Labor Life Insurance Company and the second mortgage was held by Doug Hale a former owner of the property who had sold it to Fiorella or to Chateau DeVille, Ltd. For reasons not material to this case, First Commercial Bank funded only $900,000.00 of the million dollar note at first but subsequently agreed to fund the remaining $100,000.00 and to extend an additional $60,000.00 in credit to the partnership. However, Jamison was required to pledge an additional $100,000.00 letter of credit and a $12,000.00 certificate of deposit as additional collateral to obtain the full funding and the $60,000.00 advance. Jamison agreed to do that and on December 29, 1987, executed the necessary documents to accomplish that transaction.

Maner personally made no specific representations concerning the project prior to September 28th. Up until that date, when Jamison made his initial investment, all representations had been made by Fiorella. Maner did, following September 28th and prior to December 29th when Jamison made his additional investment, represent to Jamison that "all was well" with regard to the project, that occupancy continued to be strong, that rent collections were steady and that there were no problems. Maner acted as a co-general partner in the limited partnership with Fiorella, but Fiorella ran the business end of the company on a day-to-day basis and Maner was more involved in sales and renovation projects connected with the partnership.

In February 1988 Fiorella called a meeting when Jamison for the first time learned that 28 of the 174 apartments shared meters and therefore the partnership was paying utilities for those tenants. Jamison was also informed for the first time that the apartments had not been operating with a positive cash flow but in fact were operating on a negative cash flow basis. He also learned later that year after litigation commenced in the United States District Court for the Northern District of Alabama that the rent receipts of Chateau DeVille Apartments were commingled in a single account of Equity Resources Management, Inc., with the rent proceeds of numerous other apartment complexes managed by ERMI. During that litigation he also learned for the first time that Fiorella, in calculating the percentage of occupancy of the apartments, included units provided free as part of compensation granted to resident managers and other employees of the partnership even though those units generated no income to the partnership.

Jamison also learned during that litigation that occupancy rates and income had substantially declined beginning in October 1987, immediately after he became a limited partner. Neither Fiorella nor Maner ever revealed this decline in revenue that occurred immediately after he invested which amounted to a 20% reduction or approximately $10,000.00 per month. Indeed Maner had specifically told him that everything relating to the apartments was operating satisfactorily as of November of 1987.

During the litigation in the Northern District of Alabama Jamison obtained documents establishing that for the three months immediately preceding his investment, that is June, July and August of 1987, occupancy rates ranged from 89 to 93%, that total income amounted to $163,680.00 and total expenses amounted to $89,371.00 for an actual net operating income for the quarter immediately preceding his investment of approximately $74,300.00. Nevertheless the information he was provided had projected total income for the final quarter of 1987 to be $176,493.00 and total expenses of $69,600.00 leaving a projected net operating income for that quarter of approximately $107,000.00 for a total swing between the projected and actual income figures of $33,000.00 or an approximate 40% overstatement. (Exhibits P-17, P-18 and P-19).

Moreover, in the litigation in the Northern District of Alabama Jamison obtained documents showing the actual rent rolls on a weekly basis of the project including the week of September 16, 1987, the actual week in which he initially invested. This showed an occupancy rate of 88% including two management units or an effective occupancy rate closer to 86% (Exhibit P-22). Subsequently on September 25, 1987, three days before his investment, actual occupancy was 93% including two free units or a net occupancy rate of 91% rather than the 99% represented in the brochure. Fiorella admitted that the actual operating performance of the apartment complex was made known to him by periodic reports which he ordinarily would receive between the tenth and the fifteenth day of the month following the close of business for the preceding month. Accordingly, prior to the time Jamison made his initial investment Fiorella would have seen and had access to the actual operating results for the months June, July and August of 1987 which showed substantially less net operating income and lower occupancy than that represented to be the case in the brochure (Exhibit P-3). Fiorella acknowledged that the occupancy rate fell from about 92% to about 80% immediately after the September 1987 investment by Jamison (Exhibit P-23). Fiorella testified that one of the bases on which he attempted to interest Jamison and others in the property was the tax losses that an investor could claim as a limited partner in this project which were preserved following the 1986 tax law changes and were unavailable to limited partnerships formed subsequently. Jamison and his CPA, however, established that he did not need to shelter any income at the time of his investment and in fact has recognized no tax benefit as a result of his investment or the losses which he sustained. At no time before Jamison invested or prior to the time that he increased his financial commitment to the project was he provided any of the actual figures as to the apartment complex's operations.

Shortly after the February meeting Chateau DeVille defaulted in its payments to Union Labor Life Insurance Company on the first mortgage and Jamison was asked to fund those payments in order to protect his investment which he did for a period of several months. Ultimately, Chateau DeVille, Ltd., filed Chapter 11 and eventually the property was foreclosed upon by the first mortgageholder. On September 2, 1988, his lines of credit were called by the third mortgageholder due to the default in payments on the first mortgage. His letters of credit totalling $450,000.00 were applied to the debt and he signed note modification

agreements establishing a payment schedule for retirement of the balance after the funds represented by his letters of credit were applied to the loan (Exhibits P-30 and P-31). Jamison has made all interest payments on the two notes since they were executed and at no time has Fiorella or Maner paid any of the obligations to the holder. Jamison's total loss in this project, subsequent to his investment, amounts to $897,694.87 after applying total credits for monies received from Fiorella in the amount of approximately $404,000.00 (Exhibits P-32 through P-38).

At the time Jamison brokered the first mortgage to Union Labor Life Insurance Company he visited the premises, provided operating statements to the company, examined rent rolls and other documents, none of which he did at the time of his personal investment. He testified, however, that he did not require the same degree of disclosure of Mr. Fiorella that the lender had previously required because he had known Mr. Fiorella for several years, had been involved in a number of transactions with him and trusted him and relied on his representations without seeking independent verification. He never saw any contract or other evidence of the anticipated sale to the third party which was expected to yield a quick profit but again relied on Fiorella's statement that the deal was virtually in place because of his comfort level with Fiorella's representations based on past experience. At the time of the transaction, Fiorella's financial statement showed a multi-million dollar net worth. Subsequent to the litigation between them Fiorella had assigned to Jamison mortgages and made a cash payment of $100,000.00 which the parties agreed would represent a full satisfaction of Fiorella's liability to Jamison.

Doug Hill, Jamison's CPA, attended the September 11th meeting and heard Fiorella's representations of 99% occupancy and positive cash flow as well as the representations about the probable sale at a $300,000.00 profit made by Fiorella on that date. David Bowers likewise attended the September 10th and 11th meetings in his capacity as a CPA for Jamison and testified that Fiorella made the same representations to Jamison and the others present. Bowers participated in much of the discovery in the previous litigation between the parties and specifically was present at the time Fiorella allegedly produced "all the documents" that related to ERMI in that litigation. Bowers testified that no ledgers of ERMI which were

produced in that litigation from which he could determine how funds of Chateau DeVille, Ltd., which were commingled with funds earned by other limited partnerships were applied. Accordingly, he was unable to testify whether the rents earned by this partnership were properly handled and accounted for by ERMI or not. The records produced by Fiorella show that from January to August 1987 when Chateau DeVille Apartments were being managed by Boothby Management total income per month never fell below $50,000.00. In September 1987 when occupancy rates were shown to be approximately the same as they had been in August, monthly income dropped from $51,000.00 to $42,000.00. September 1987 was the first month after ERMI took over management of the complexes (Exhibit P-26). Documents obtained during that litigation also reveal that from January to December 1987 cash flow of Chateau DeVille, Ltd., was a negative $87,156.33. In at least one month management fees were charged by ERMI totalling 7% of gross income rather than the 6% maximum provided for in the agreement (Exhibit P-27). Debtor offered no explanation of the sudden $10,000.00 per month drop in income which occurred when ERMI assumed management of the complex and did not contradict the evidence that the complex was in a negative cash flow position for all of 1987.

Fiorella admits showing the brochure (Exhibit P-3) to Jamison when he met with him in September 1987. Fiorello also established that while Maner did not assist in the preparation of the brochure, Maner had seen the brochure and had used it when he sought to sell interests in the limited partnership to investors prior to the time the brochure was presented to Jamison in September.

Brian Considine, an MAI appraiser, was qualified as an expert and testified to establish the factors about an apartment complex that are material in establishing value. He testified that occupancy rates are critical, that knowing whether management units are included or not included is important, that separate metering of apartments is a material factor, that a representation that a complex is 99% occupied is not reasonable when the actual figures range from 89% to 93%. He likewise established that the pro forma statement which showed expenses of approximately 40% was understated and in fact the actual expenses for June of 1987 were 47.56%, for August of 1987 were 50.84% and that a 40% projection was unreasonably low. He concluded that occupancy had been overstated by approximately five to seven percent and that expenses had been understated by approximately seven to ten percent. Nevertheless he admitted that he could not render

an appraisal of the value of the project based on the information contained in Exhibit P-3 alone.

CONCLUSIONS OF LAW

Debts obtained by fraud are non-dischargeable in a bankruptcy proceeding. Section 523 of the Bankruptcy Code provides in pertinent part:

> (a) A discharge . . . does not discharge an individual debtor from any debt--
>
> (2) for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by--
>
> (A) false pretenses, a false representation, or actual fraud, other than a statement representing the debtor's or an insider's financial condition;
>
> (4) for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny;

The burden of proof is upon the plaintiff excepting to discharge to show by a preponderance of the evidence that a discharge is not warranted. Grogan v. Garner, __ U.S. __, 111 S.Ct. 654, 112 L.Ed. 2d 755 (1991). The Supreme Court in Grogan held that the preponderance of the evidence standard, instead of the clear and convincing evidence standard, should apply to all of the exceptions to discharge provisions of 11 U.S.C. Section 523(a). Dischargeability of a debt is based upon federal bankruptcy law and not state law. Id. at 658. The preponderance of the evidence standard, instead of the clear and convincing evidence standard, should apply to the exception to discharge for fraud. Id. at 660-661.

I. Fraud and the Requirement of Reasonable Reliance.

In order to preclude the discharge of a particular debt because of fraud, a creditor must prove the following:

(1) The debtor made a false representation with the purpose and intention of deceiving the creditor;

(2) The creditor relied upon such representation;

(3) The reliance was reasonably founded; and

(4) The creditor sustained a loss as a result of the representation.

In re Hunter, 780 F.2d 1577, 1579 (11th Cir. 1986); In re Phillips, 804 F.2d 930 (6th Cir. 1986); In re Lacey, 85 B.R. 908 (Bankr. S.D.Fla. 1988). *See also* In re Mullet, 817 F.2d 677 (10th Cir. 1987) (Reliance must be reasonable); In re Kimzey, 761 F.2d 421, 423 (7th Cir. 1985) (Plaintiff must demonstrate reasonable reliance on the debtor's representations); Matter of Carpenter, 53 B.R. 724, 729 (Bankr. N.D.Ga. 1985) (actual fraud).

The type of fraud which will except a debt from discharge is "positive fraud, or fraud in fact, involving moral turpitude or intentional wrong . . . " Hunter, 780 F.2d at 1579. Fraud may be established from circumstantial evidence. Chase Manhattan Bank, N.A., v. Flowers, CV#587-036, slip op. at 9-10 (S.D.Ga. Jan. 11, 1988) (citations omitted). Additionally, intent to defraud may be inferred from the totality of the circumstances. In re Lacey, supra.

The Eleventh Circuit specifically requires a creditor to prove that he reasonably relied upon a debtor's misrepresentation. Hunter, supra. Accord, Mullet, 817 F.2d at 680; Kimzey, 761 F.2d at 423; In re Howarter, 95 B.R. 180 (Bankr. S.D.Cal. 1989) aff'd, 114 B.R. 682 (9th Cir. BAP 1990). The Sixth Circuit also requires reasonable reliance but concludes that the requirement should not be rigid. According to the Court, "reasonableness is circumstantial evidence of actual reliance; that is, dischargeability shall not be denied where a creditor's claimed 'reliance' . . . would be so unreasonable as not be actual reliance at all." In re Garman, 643 F.2d 1252, 1256 (7th Cir. 1980), cert. denied, 450 U.S. 910, 101 S.Ct. 1347, 67 L.Ed 2d 333 (1981). In re Phillips, 804 F.2d at 932-33 (Other citations omitted).

The Tenth Circuit has also discussed the reasonable reliance requirement of Section

523(a)(2)(A).

> This standard of reasonableness places a measure of responsibility upon a creditor to ensure that there exists some basis for relying upon the debtor's representations. Of course, the reasonableness of a creditor's reliance will be evaluated according to the particular facts and circumstances present in a given case.

Mullet, 817 F.2d at 679.

In discussing reasonable reliance under Section 523(a)(2)(B), one court concluded:

> [R]easonableness is simply a measure against which circumstantial evidence that tends to prove or disprove reliance is to be compared. It should be viewed as a test of credibility. Reasonableness is not, with respect to the victim of an intentional tort, a framework of legal standards fashioned from an affirmative duty.

In re Richards, 71 B.R. 1017, 1022 (Bankr. D. Minn. 1987).

Other courts have judged reliance by the reasonably prudent man standard. In re Sullivan, 58 B.R. 692 (Bankr. D. Mass. 1986). *See also* In re Bright, 57 B.R. 233 (Bankr. N.D. Ohio 1986); In re Icsman, 64 B.R. 58 (Bankr. N.D. Ohio 1986) ("Reasonable reliance is that degree of care which would be exercised by a reasonably cautious person in an average business transaction under similar circumstances.") A creditor's relative sophistication in business matters should be considered in determining reasonable reliance. Matter of Newmark, 20 B.R. 842, 861 (Bankr. E.D.N.Y. 1982).

The emerging standard to determine reasonable reliance is "to compare the creditor's actual conduct to the creditor's own business practice and standards and customs of the industry, in light of the surrounding circumstances existing at the time the application was made and credit extended." In re Ardelean, 28 B.R. 299 (Bankr. N.D. Ill. 1983). *See also* Matter of Patch, 24 B.R. 563 (D.C. Md. 1982). Although

Ardelean and Patch deal with a business institution's reliance upon a financial statement under Section 523(a)(2)(B), the analysis is helpful.

A significant factor to be taken into consideration in determining reasonable reliance is the prior dealing and prior relationship between the parties. In re Phillips, 804 F.2d 930, 933 (6th Cir. 1986); In re Icsman, 64 B.R. at 63; In re Gitelman, 74 B.R. 492, 496-97 (Bankr. S.D.Fla. 1987).

In Phillips, supra, the Court concluded that commercial lender cases were not applicable to a situation involving a personal loan between individuals who had a 25-year relationship. According to the Sixth Circuit, "friendship or a close personal relationship weighs heavily in favor of finding reasonable reliance." Phillips, 804 F.2d at 933. A creditor's dealing with a long standing customer also indicates reasonable reliance. Gitelman, 74 B.R. at 496-97. If a creditor has had favorable dealings with a debtor and under the circumstances can expect the obligation to be satisfied, then the Court should find reasonable reliance. Icsman, 64 B.R. at 63 (Discussing reliance upon a financial statement). Additionally, if a creditor has information in addition to what is set forth on a financial statement which would lead a prudent business person to reasonably believe that he could satisfy his debt from debtor's assets, then a lower standard of reasonable reliance should be applied. Id. at 64.

As applied to the facts in this case, I find that Plaintiff has established the elements of fraud under Section 523(a)(2)(A) by a preponderance of the evidence. Fiorella intentionally made a false representation to Jamison. The representations were material, inducing Jamison to make his investment and become obligated on partnership obligations. Jamison relied on Fiorella's misrepresentations. Jamison believed that the apartment complex was doing substantially better than the actual figures of occupancy and income would have reflected, had he been given access to them, and the potential sale at a profit was no longer viable as of September 11, 1987. Most importantly, the complex did not operate at a positive cash flow for all of 1987 despite representations in September and after that it was.

It was reasonable for Jamison to rely on those misrepresentations. Jamison and Fiorella had a prior business relationship. Jamison had worked with Fiorella before without any problems, and believed he could trust Fiorella, who apparently had a reputation as a successful businessman with a substantial net worth. Jamison had no reason to doubt Fiorella's word. If Jamison had not known Fiorella and given the same facts I might conclude that there was a duty to inquire and verify the representations. *See* Icsman, 64 B.R. at 63 (A creditor relying on a financial statement pursuant to Section 523(a)(2)(B), must make a reasonable inquiry into the information provided by a debtor in order to show reasonable reliance). *See also* In re Sullivan, 58 B.R. 692 (Bankr. D.Mass. 1986). However, under the facts and circumstances, I cannot conclude that Jamison had a duty to independently verify the information provided by Fiorella. I rule that it was reasonable for Jamison to assume he could rely on the figures Fiorella provided without insisting on certified audits and actual operating statements.

Jamison has also shown a loss from the misrepresentations. His lines of credit were called by the third mortgageholder and assets he pledged were taken in satisfaction of his obligations. Jamison's total loss from his involvement in the project is $897,694.87, after crediting amounts paid by Fiorella. Therefore, I hold that Plaintiff has established each element of fraud, including the requirement of reasonable reliance, as to Fiorella.

With respect to Debtor's liability for actual fraud, Maner made no direct representations concerning the project prior to September 28; all representations prior to September 28 were made by Fiorella. However, Maner did represent between September 28th and December 29th that the project was successful, that occupancy was strong, and that rent collections presented no problems. Although Maner did not make a representation which induced Jamison to make his initial investment, Maner as a co-general partner in the project benefitted from Jamison's investment in the partnership and did make representations prior to the second investment which I find to be materially false and on which Jamison reasonably relied when he pledged an additional $112,000.00 on December 29, 1987. However, as to the initial $700,000.00 investment, Fiorella was the perpetrator of the fraud and Maner's liability to Jamison and non-dischargeability of that debt if any

must be decided only as a matter of imputed fraud.

II. Imputed Fraud.

The courts are split on whether the fraud of one partner may be imputed to another in determining the dischargeability of a debt under 11 U.S.C. Section 523(a)(2)(A). Some courts have held that the fraud of an authorized agent, without more, may be the basis for non-dischargeability of the principal. *See* In re BancBoston Mortgage Corp. v. Ledford, 127 B.R. 175 (M.D.Tenn. 1991).

The Eleventh Circuit recently affirmed without opinion a case in which the Bankruptcy Court discussed fraud imputed to a debtor under Section 523(a)(2)(A). In re Powell, 95 B.R. 236, aff'd, 108 B.R. 343, aff'd, 914 F.2d 268 (11th Cir. 1990) (table). The Bankruptcy Court in Powell held that debtor had committed the fraud in his own right, but that even if the agent had committed the fraud, such fraud could be imputed to the debtor to find the debt non-dischargeable. Powell, 95 B.R. at 240. The Court noted that numerous cases have held that fraud may be imputed to a principal debtor whether or not the principal knew or should have known of the fraud. Id. *See* In re Hosking, 89 B.R. 971, 977 (Bankr. S.D.Fla. 1988); In re Paolino, 89 B.R. 453, 458 (Bankr. E.D.Pa. 1988).

Other courts have refused to impute the fraud without some showing of knowledge, intent, or at least reckless indifference. *See* Matter of Walker, 726 F.2d 452 (8th Cir. 1984) (Walker I). However, Walker I and its reasoning has been criticized in at least three subsequent opinions. *See* In re Paolino, 75 B.R. 641 (Bankr. E.D.Pa. 1987) (Notwithstanding the interpretation of Section 523(a)(2) exemplified by the Walker I line of cases, an agent's fraud may be imputed to the principal without a showing of knowledge); In re BancBoston Mortgage Corp. v. Ledford, 127 B.R. 175 (M.D.Tenn. 1991) (Fraud of one partner may be imputed to another partner under Section 523(a)(2)(A) without proof of the debtor/partner's knowledge or wrongful conduct); In re Calhoun, 131 B.R. 757 (Bankr. D.D.Col. 1991) (Fraud may be imputed to an innocent partner or principal). *See generally* 3 Collier on Bankruptcy, §523.08[4] at 523-57 (15th Ed. 1991); In re White, 130 B.R. 979, 987 (Bankr. D.Mont. 1991).

In Matter of Walker, 53 B.R. 174 (Bankr. W.D.Mo. 1985) (Walker II), the Bankruptcy Court on remand criticized the Eighth Circuit's opinion in Walker I, asserting that the court's opinion was based on authorities relating only to a debtor's discharge as opposed to dischargeability of a debt. The other decisions rejecting Walker I have also reached the conclusion that the Eighth Circuit incorrectly cited authorities regarding discharge. *See* In re Calhoun, 131 B.R. at 761. In Walker II, the Bankruptcy Court, after conducting another evidentiary hearing, concluded that the fraud of debtor's wife should be imputed to the debtor. Additionally, and in accordance with Walker I, the Bankruptcy Court concluded that debtor should have known of his wife's wrongful conduct. As a result, the Bankruptcy Court again held the debt to be non-dischargeable. Walker, 53 B.R. at 182.

Walker I is not without its adherents. *See* In re Aste, 129 B.R. 1012 (Bankr. D. Utah, 1991), where the Bankruptcy Court concluded that if the debtor had no reason to believe that information in a false financial statement prepared by an employee was incorrect and failed to verify the information, reckless intent should not be inferred. The Court could find no actual intent to mislead on debtor's part. The Bankruptcy Court cited Walker I for the proposition that a debtor must have known or should have known of the agent's wrongful conduct to declare the debtor's debt non-dischargeable. According to the court, debtors should be able to rely upon information provided by competent, reputable employees, and any other conclusion would require undue duplicative source checking. 129 B.R. at 1020. However, the debtor in Aste was the employer of and not the partner of the dishonest employee. Thus the case is factually distinguishable from the case before me.

On the other hand, in BancBoston Mortgage Corp. v. Ledford, supra, a case involving partners accused of fraud, the District Court held that a general partner's fraud could be imputed to an innocent partner under Section 523(a)(2)(A), without the "knew or should have known" requirement. In a lengthy discussion of imputed fraud, the Court ruled that "the better reasoned case law supports the imputation of fraud without knowledge." 127 B.R. at 182. The Court rejected Walker I for relying on discharge cases as opposed to cases involving dischargeability of a debt. The District Court relied on the holding of Strang v. Bradner,

114 U.S. 555, 5 S.Ct. 1038, 29 L.Ed. 248 (1885), in which the Supreme Court held that fraud could be imputed to an innocent partner in a dischargeability action.

Strang, supra, is similar to this case as one partner defrauded creditors without the knowledge of the other partners. According to the Supreme Court:

> Each partner was the agent and representative of the firm with reference to all business within the scope of the partnership. And if, in the conduct of partnership business, and with reference thereto, one partner makes false or fraudulent misrepresentations of fact to the injury of innocent persons who deal with him as representing the firm, and without notice of any limitations upon his general authority, his partners cannot escape the pecuniary responsibility therefor upon the ground that such misrepresentations were made without their knowledge.

Strang, 114 U.S. at 561, 5 S.Ct. at 1041. Likewise, in a very recent decision the Fifth Circuit has adopted this rule. *See* Matter of Luce, 960 F.2d 1277 (5th Cir. 1992) (substituted opinion on rehearing). In Luce, the Fifth Circuit ruled that fraud may be imputed to an innocent partner without regard to knowledge or involvement.

According to the Court, Mr. Luce acted on behalf of the Luce Partnerships and in the ordinary course of business when he made certain false representations. As a partner, Mrs. Luce benefitted from the fraudulently obtained funds which were in part converted for the couple's personal use. The Bankruptcy Court imputed Mr. Luce's fraud to Mrs. Luce and found the debts of both to be non-dischargeable. The Fifth Circuit concluded that Mr. Luce's fraud could be imputed to Mrs. Luce regardless of her knowledge. Additionally, the Court emphasized Mrs. Luce's benefit and use of the funds despite her testimony that she never saw the money. Luce, 960 F.2d at 1283.

Finally, in Terminal Builder Mart v. Warren (In re Warren), 7 B.R. 571 (Bankr. N.D.Ala. 1980), the Bankruptcy Court concluded that the question is "well-settled" that "a debt arising from the

obtaining of goods by false pretenses of a partner, acting for the partnership, constitutes a claim which is not dischargeable in bankruptcy as to the misbehaving partner, the partnership, or an innocent partner." Warren, 7 B.R. at 573.

The Warren case is especially persuasive here as the partnership between Fiorella and Maner is governed by Alabama law. Under Alabama law partners owe fiduciary duties to each other and are jointly and severally liable for partnership debts. *See* Alabama Code §§ 10-9A-62; 10-8-48; 10-8-49; 10-8-52; 10-8-53 and 10-8-54. *See generally* In re Intern. Resorts, Inc., 46 B.R. 405, 417-18 (N.D.Ala. 1984), aff'd, 751 F.2d 392 (11th Cir. 1984) (table). Alabama Code Sections 10-9A-62 and 10-8-53 together provide that general partners in a limited partnership are liable for each other's acts in the ordinary course of business, including vicarious liability for compensatory damages from a partner's alleged misrepresentations. *See* Reynolds v. Mitchell, 529 So.2d 227 (Ala. 1988).

I conclude that the proper standard to be applied is one which permits the fraud of one partner to be imputed to even an innocent co-partner. The Strang decision of the United States Supreme Court standing along is sufficient authority. Despite its age and subsequent statutory changes in bankruptcy law its rationale is compelling. Moreover, despite some contrary authority, the majority and better-reasoned more modern decisions follow Strang. Finally, although the Eleventh Circuit has not expressly ruled on this issue, its affirmance in Powell, supra, is suggestive that it would follow the Fifth Circuit holding in Luce, supra, rather than the Eighth Circuit in Walker I, supra.

I thus rule that as to the September misrepresentations, although Maner was an innocent partner, nevertheless Fiorella's fraud is imputed to Maner and the debt owed to Jamison is non-dischargeable pursuant to 11 U.S.C. Section 523(a)(2).

III. Fraud Under Section 523(a)(4).

Because of my ruling on the Section 523(a)(2) claims it is unnecessary to rule on Plaintiff's alternative theory under Section 523(a)(4).

ORDER

Pursuant to the foregoing Findings of Fact and Conclusions of Law, IT IS THE ORDER OF THIS COURT that the debt owed John W. Jamison, III, in the amount of $897,694.87 shall be non-dischargeable pursuant to 11 U.S.C. Section 523(a)(2)(A).

Lamar W. Davis, Jr.
United States Bankruptcy Judge

Dated at Savannah, Georgia
This ____ day of July, 1992.